

REPORT AND RECOMMENDATIONS ON HUMAN RESOURCES FOR THE BANKING SYSTEM OF MONGOLIA

INTRODUCTION

The World Bank is currently considering a new Financial Sector Adjustment Credit for Mongolia, expected to be the equivalent of the US \$32 million, which will be considered by the Bank's board in April, 2000. As a condition to approval of this credit, the Bank of Mongolia has agreed to adopt an action plan to address support to the financial sector, per the following:

“Government has adopted an action plan, satisfactory to IDA, to develop a comprehensive program to support a healthy financial sector including banking and supervision skills, accounting and auditing standards, governance and enforcement of financial contracts.”

A major focus of the action plan, and indeed of successful performance by the banking sector, concerns human resources: the proper staffing of banking and oversight positions, with appropriate training and direction. Accordingly, the Bank of Mongolia and the World Bank requested that the Economic Policy Support Project (EPSP) of USAID arrange for an assessment of human resources of the banking system, to test the Bank of Mongolia's supervisory capacity, as well as the capacity of the commercial banks to deliver banking services in a responsible and prudent manner, and to describe what actions, changes, and training would be needed in the short term (within the year), medium term (by 2005) and long term (by 2010) to support this.

A two person team spent some three weeks in Mongolia talking and reviewing procedures with Bank of Mongolia management and staff, the management and staff of several of the commercial banks, representatives of the Ministries of Finance and Justice, deans of the local university business programs, directors of emerging non-bank financial institutions, as well as donors, consultants, and others involved with bank reform. A list of these contacts is attached as Annex A. The team also reviewed recent World Bank and Asian Development Bank evaluations of prior structural adjustment credits, other financial reviews, Bank of Mongolia documents, and other recent literature relevant to the Mongolian Banking System. A list of sources consulted is attached as Annex B.

This report discusses the current situation, and makes recommendations, in the following key areas:

- Governance
- Bank Regulation
- Credit
- Internal Control (Audit)
- Legal
- Accounting

- Human Resources
- Banking Association
- Systems
- Customer Service and Marketing
- Treasury
- International
- Banking Services in Rural Areas
- Non-Bank Financial Institutions
- Training

In many respects the last topic, training, is a cross-cutting issue that is discussed in all sections. However, there are major aspects of training, including delivery methods and the institutionalization of training itself, which warrant specific attention.

It is important to remember that change in human resources is necessarily a gradual process. There are no quick fixes that can be applied in this area: the banking and supervisory system will improve as staff receive more training, and an environment is created where lessons can be practiced and become engrained behavior.

While attention to human resources will go a long way in creating a strong financial system, there are several problems in banking that are not personnel issues, but do require prompt attention to ensure that the banking system will be able to play its vital role in the development of the Mongolian economy. The problems recited below are critical to healthy resolution of the Mongolian banking system, but either cannot be addressed with human resources solutions or can only be marginally addressed this way. We do list these, however, to emphasize that attention to personnel issues alone is not sufficient. These include:

- Nonpayment or irregular payment of interest on government bonds; illiquidity of the bonds.
- Government and parliament involvement and interference with Bank of Mongolia functions.
- High real interest rates.
- Continued state ownership of banks and domination of the banking system, which inhibits private initiative, and leads to undue political pressure.
- Inadequate enforcement of laws concerning collateral and enforcement of legal contracts.
- Inadequate enforcement of anti-corruption laws.
- Need for bank consolidation.
- Weak economic sector.

In recent years the Mongolian banking system has weathered some severe shocks, including several bank failures, and at present the situation can best be described as very fragile. Notwithstanding, the team did see signs of progress both at the Bank of Mongolia and at individual commercial banks, including initiative in seeking markets and

developing internal control systems. Continued attention to the development of the personnel who make up the banking system will be a significant element to putting the banking system on a firmer footing, so that it can play its critical catalytic role in the development of the economy.

It is important for the human resources plan to acknowledge that the banking environment is fluid. It must be flexible and robust enough to anticipate not only the needs of the present players in the banking system, but also those of new entrants who may or may not be on the scene at present. Currently there are eleven banks operating in Mongolia, with a heavy concentration of assets in the three largest banks. The Trade and Development Bank (TDB), the largest of the commercial banks, is a majority state-owned bank that is performing well, and ideally will be further privatized with partial foreign ownership. The Savings Bank is funded with household deposits, but essentially does no lending, thus holds most of its assets in illiquid government bonds. Golomt Bank is privately owned by a single shareholder, a Mongolian – European financial company joint venture that also has a leasing company and an insurance operation in the group.

Three state-owned banks, which historically have also been among the largest banks in the country, have negative capital accounts. Two of these, ITI Bank and Reconstruction Bank, are in the process of liquidation. The Agricultural Bank remains in receivership, and while weak, is the major provider of banking services in the regions. Four small private banks are also in the process of liquidation.

Given the size and population of the country, ideally the banking system would comprise five or six banks that would offer sufficient competition to each other to ensure a range of needed banking services at competitive prices, yet could operate profitably. As noted above, currently only TDB and Golomt could reasonably be expected to operate in such a competitive market. At present the country is overbanked in the sense that there are too many banks, and the Bank of Mongolia is appropriately encouraging mergers and financial strengthening of the banks through increased capital requirements, from the current MNT 1 billion in capital to MNT 2 billion by June 30, 2001.¹ Since none of the other eight private banks now has this level of capital, mergers are likely. Overall, given the restructuring that will be required in both the state and private banks, it is clear that the banking system will be greatly changed in the next few years. This means that a human resources plan must necessarily address the future needs of the industry, not just the immediate needs of the current players.

Among the commercial banks much of the training and assistance historically has been directed to Golomt and TDB, two of the apparent long term players in the Mongolian banking system, as well as to the Agricultural Bank. However, in order to assure that three to four other institutions that will be part of the financial community can emerge and be strong participants, training and assistance should be broadly available, or even directed to banks other than these.

¹ The required capital level was lifted to MNT 1 billion as of September 30, 1999. Several banks did not meet this capital requirement, and had their banking licenses revoked. One of these has been converted to a finance company, and another is presently applying to the Bank of Mongolia for a finance company license.

GOVERNANCE

Bank Directors

Governance is one of the most important issues to address in overcoming the problems in establishing a viable ongoing banking system in Mongolia. The major reason for many recent bank failures can be attributed to lack of an acceptable level of governance among directors and senior officers of the banks.

Bank directors in Mongolia are chosen by the state in the case of state owned banks and by the shareholders for private banks. Where there is mixed state/private ownership such as with Trade & Development Bank, seats on the board are shared between directors chosen by the state and the shareholders. State bank director nominees are chosen by the State Property Committee with the knowledge of the Central Bank. At the present time, the Central Bank does not become involved in the appointment of directors elected by shareholders unless the proposed incumbent has a criminal record or has a bad personal financial reputation. In other words, the Central Bank does not intervene on the basis of lack of competence in the case of either private or state director appointments. We believe that the Central Bank should extend its criteria for bank directorship appointments to include an assessment as to whether the individual proposed has the necessary depth of business knowledge and thus is capable of performing a bank director's role competently.

There is an urgent need for appropriate training to provide /instruction not only to newly appointed directors, but to existing directors as well. State-appointed directors need to be included in such a program. The level of knowledge required of a bank director must be sufficient to enable the incumbent to monitor management performance based on agreed criteria. While in-depth knowledge of banking may not be necessary, an understanding at least of the major risks a bank faces is essential. This must include credit, liquidity and funding risks. While some current directors are bankers or former bankers with a greater or lesser degree of banking know-how, others have no banking knowledge at all. Since banking is changing quite rapidly in Mongolia, there is a need to update the skills even of those directors who were former bankers or who were knowledgeable about banking matters in the past.

Another key concern is the issue of insider trading, the broad term given to the process of making decisions, exerting influence or taking some kind of action which may lead to enrichment for either the individual and/or friends and associates of the individual concerned, often at the expense of the institution. While legislation to deal with insider dealing is currently in place, there is a real problem with the execution.

All directors, both state and privately appointed directors, should undergo governance instruction. This should be provided under the auspices of the Central Bank which, as regulator, has a key role to play in ensuring that incumbents are qualified and capable in addition to having the moral character to justify the appointment to a bank directorship.

Two main topics should be covered. Firstly, the subject of insider trading should be thoroughly dealt with to ensure that all directors are aware of their responsibilities and the consequences of not complying with the high level of governance standards which are in place. Secondly, for non-banker nominees or those whose banking knowledge is not up to date, basic knowledge necessary to monitor senior management should be included.

Initially, it may be necessary to seek assistance from a foreign source, such as a foreign central bank or regulator, to help devise a basic program of bank director education. The Central Bank should ensure that the foreign designed program is relevant for the Mongolian model. The Ministry of Justice should assist with the instruction involving the governance issues. All existing directors should be required to undergo a course of instruction regarding governance issues, as well as on banking issues if their level of banking knowledge is not considered sufficient to effectively monitor senior bank management's performance. We believe that most bank directors would agree that some basic instruction and guidance would be useful in helping them perform their role more effectively. The instruction could be provided through a series of meetings and seminars with Central Bank senior officials including the Governor and Deputy Governor.

The directors' role is very broad and should be confined to major policy decisions. Directors should delegate all but the most important decisions to senior management. A key aspect of the arrangement should be a clearly worded policy setting out senior management's authority. However, directors must also be able to judge the likely effect on the banks' operations that policy decisions will have, which is why a clear understanding of not only banking but general business concepts is necessary.

Taking into account the recommendations of management, directors must establish a set of specific criteria or goals for the bank's operations. These goals should include such benchmarks as return on equity, return on assets, loan losses, capital adequacy ratios, etc. Management performance and compensation can then be based on whether these criteria or goals are accomplished.

Directors must expect and insist that management provide accurate information to support their recommendations on any major policy questions which require their decision. Directors must also hold senior management responsible for carrying out policy and to meet profitability and other targets. Directors need to ensure that any matters which could have a significant affect on the well-being of the bank are brought to their immediate attention by senior management.

The board of directors should meet on a monthly basis with the dates of each meeting set out a year in advance. Regular presentations by senior management should be scheduled on a variety of topics to ensure that directors remain fully informed on the bank's business. Management should ensure that department heads have an opportunity to make presentations on key aspects of their activities.

Depending upon size, a Mongolian bank should have between 5 and 10 directors. A majority of the directors should not be officers of the bank. There should be a maximum of 2 inside directors per bank.

Senior Management

Similarly, a process should be in place for the Central Bank, in its capacity as regulator of the banking system, to approve the appointment of bank senior management. This applies mainly to the chief executive and deputy chief executive appointments, since it is these positions which exercise the real control of a bank's operations. Unless the Central Bank believes there is reason for concern, the appointment of other senior management from within the ranks of the bank need not be subject to the same scrutiny since it must be presumed that the bank's executive knows the capabilities of its own employees. An exception may be appointments to the chief credit officer and the chief accountant positions as well as in the case of individuals who are new to the bank taking on key management positions.

Financial Incentives

This topic will be discussed under the human resource section of the report but it is relevant to mention it briefly under governance since one of the major reasons for governance violations is lack of appropriate financial incentives. Management should be adequately compensated and directors should receive a fee based upon attendance at meetings.

BANK REGULATION

A great deal of time and attention has been given to the supervision department of the Bank of Mongolia, to good effect. This department has a staff of 38 in Ulaan Baatar, including 12 supervisors and 16 examiners, and 22 staff on the aimags. The department has an examination/certification program, including a three month internship period, and an exam to qualify to be a state inspector that can only be taken after a two year period as a junior inspector. There is also an annual re-certification process.

There have been substantial training opportunities for the examiners, including regular foreign study programs at the Joint Vienna Institute and various central banks. Supervision staff have also regularly attended training courses through the Banking Training Center, and as noted above, have weekly seminars to discuss current topics. We encourage continuation of these training initiatives, and further encourage the Bank of Mongolia to investigate the possibility of distance learning through internet courses, so that valuable personnel are not gone from the country during this critical time. The director of the supervision department noted that although the bank examiners could use more detailed training, she felt that there were more deficiencies in the learning of commercial bank staff, particularly in the internal audit and control areas, and that attention to this was a greater priority.

Another ongoing need that the director of the supervision department noted, both within her own department and in the commercial banks, is the need for an attitude change about regulation and control. Bank exams have historically been a passive exercise, checking for the accuracy of transactions that have been concluded, and slapping wrists for errors. There needs to be a re-focus of exams, and internal controls, to pro-active direction and anticipation of problems. This change is coming at the Bank of Mongolia, and also needs to be encouraged at the commercial banks. There needs to be an increased emphasis on training in internal controls and auditing. Courses in this area should be refreshed, changed, and newly drafted to take an activist approach. The examinations themselves, as they improve, will become more useful in anticipating problems in the banks, and will become more of a learning experience for the banks.

The Bank of Mongolia is constantly in the process of revising its regulations and guidelines so that reporting from the banks is better, and the banks have a better grasp of their operations. A recent example of this is the revised loan classification system, which is trying to put more emphasis on qualitative analysis of loans to anticipate problems, rather than to rely heavily on payment aging, which identifies borrower problems only after they have occurred. The Bank of Mongolia could benefit from having an expert “on call”, who could advise on implementing international standard regulations and the Basle Accords. This person would not have to be in Mongolia full-time, as the intent would be more to have a source of information on retainer. When in country this person could deliver training and seminars for the bank examiners. It would also be valuable to have experienced foreign examiners in-country for some time, so that Bank of Mongolia examiners would have the opportunity to learn from them, on the job.

It seems that communication of these regulatory and guideline changes gives the Bank of Mongolia a tremendous opportunity to have a leadership role in the development of the commercial banks. The supervision department already holds internal development seminars for its own staff, and it seems that it would be relatively easy to hold a second session of such seminars, for the commercial bankers. This sort of presentation would provide the sort of constant reinforcement needed for learning, and should be a relatively inexpensive, yet effective, way to communicate regulatory and guidelines changes.

One other major issue that needs attention under the subject of Regulation is the necessary independence of the Bank of Mongolia in this area, with strict non-interference by other government departments and ministries. This is not a human resources issue per se, but a better understanding of the function of banks, the banking system, and the role of a Bank of Mongolia as a regulator may come through seminars presented for board directors, parliamentarians, and ministry officials.

CREDIT

When a bank fails, it is usually because it is weighed down by a poor loan portfolio and can no longer collect the interest and principal on its loans to pay its depositors and cover its overhead. Sometimes, the bad loans underwritten are the result of fraudulent activities but, more often than not, they stem from ineffective credit analysis. The recent bank

failures in Mongolia can be attributed to a combination of these factors but this section of our report deals with the question of ineffective credit practices.

In order to ensure that the credit analysis process is on a sound footing, a credit policy must be established which covers all aspects of the bank's lending program. The Bank of Mongolia should establish credit policy criteria and advise banks if their own policies do not meet these standards. Banks would have a limited time period to implement the required changes to their policy. Each bank must formulate a distinctive credit policy, to be approved by the directors, who in turn must hold senior management responsible for implementing and carrying out the credit policy. The credit policy must embrace all aspects of lending from the initial credit analysis of a loan application to the collection of the final payment of interest and principal. In devising credit policy, it is necessary to clearly establish the type of loans the bank is prepared to make. Factors to consider include, but are not restricted, to:

- the types of industry in which prospective borrowers may operate,
- the methods which are to be used to evaluate the business and financial risk,
- an objective way to measure borrower risk,
- the maximum amounts the bank is prepared to lend to any one name or group based on the risk assessment,
- terms and conditions for loans, including the type of collateral acceptable,
- loan collection and monitoring procedures.

These policies must be in written down in the form of a credit manual which must be available to all personnel who are involved in the lending practice in the bank's head office and its branches. From time to time, there will be a need to amend existing policies so there must be a way of communicating these changes to all credit personnel as quickly as possible. An important aspect in the process is to provide management with sufficient information to monitor the bank's total portfolio to ensure that the risk assumed is in accordance with the established credit policy. Finally, and most importantly, the personnel involved in the lending process must be trained to effectively carry out the bank's credit policy. Unless personnel have the credit experience and expertise to do the job, even a good credit policy will not save a bank from being flooded with bad loans which will ultimately lead to insolvency.

Industry Risk

Firstly, the bank must decide on the types of borrowers that it is prepared to consider lending to based on the industries in which they operate. It would be helpful to rank order the various types of industry according to the risk in lending to companies in that industry. For example, if the price of copper is depressed, copper producers may not be good borrowers at that particular time so the allowable amounts to be lent may be smaller and the conditions tighter. On the other hand, if the cashmere industry is booming and the outlook is for continued buoyancy, then amounts could be higher and conditions not as stringent. It is not normally a question of refusing to deal with all companies within a particular industry since the better operators will survive even when conditions are very

difficult. Conversely, not every borrower in a thriving industry will be a good one. It is a question of being selective and it is important that credit personnel are trained to distinguish between viable and unacceptable risks within a specific industry.

Business Risk and Financial Risk

Credit personnel assessing loan applications must be able to evaluate management's integrity and capabilities to ensure that the borrower is likely to survive even under difficult market conditions. This includes knowing how to review business plans to see how realistic the projections are and to be able to apply sensitivity analysis to see how safe the bank's funds would be in the event that reality turns out to be different from the forecast. The credit policy should provide lenders with guidelines as to what constitutes an acceptable range of financial ratios to assist with credit analysis.

Risk Rating

The new credit risk rating procedures developed by the Bank of Mongolia deal only with non-performing loans. An objective risk rating measurement system is essential for the total portfolio and is the corner stone to measuring portfolio quality on an ongoing basis. It is necessary to establish a scale of risk moving from the lowest risk category through to the highest risk category. The number of specific risk ratings on the scale to be used will depend on the needs of each bank, but should usually range from 6 to 10. We believe it would be appropriate for banks in Mongolia to use a risk rating scale at the lower end of this range. The credit policy should provide lenders with the risk rating criteria and the lenders need to be trained to accurately assess risk not only when the loan is initially advanced, but throughout the full term that it is on the bank's books. In turn, the bank's senior management and directors should be able to closely follow the trend of the bank's overall portfolio risk. This means that loans should be reviewed regularly, including each time a new advance is made, as well as at least on an annual basis.

Single Name and Group Exposure

The Bank of Mongolia stipulates the maximum amount which can be lent to any one borrower based on a bank's capital resources. Currently, this amount is 20% of the bank's capital. The maximum limit should only be lent to the very best borrowers and a lower maximum limit should be accorded to lesser risks. Credit policy should set out what these maximum limits should be based on the industry in which a borrower operates and the individual credit risk of the borrower. For example, the maximum amount which should be lent to a high risk borrower in a high risk industry may be only one third of the maximum amount allowed by the Bank of Mongolia. It is by incorporating such guidelines in a credit policy that Mongolian banks will be able to control their risks much better and become less susceptible to loan losses.

Terms and Conditions

Credit policy should stipulate the terms and conditions which must be incorporated into loan agreements with borrowers. Such terms and conditions include the term of the loan, interest rates (according to risk), grace periods, schedule of principle payments, security, covenants and other conditions. Lenders must be trained to determine the terms and conditions which are necessary to ensure that the bank is sufficiently protected. This requires that lenders have a good understanding of Mongolian law to ensure that the loan agreement reflects current legislation.

Loan Monitoring and Collection

Effective loan monitoring and collection procedures are essential. Personnel must be trained to follow a borrower's business and to ensure that all the commitments which have been made under the agreement with the bank are fulfilled. Loan monitoring procedure is an important part of credit policy since it is much harder to collect loans than to make them, particularly in a developing economy such as Mongolia where commercial banking practices are relatively new.

Management Information

Effective management information systems (MIS) are essential to ensure that up to date information is available to monitor the implementation of a bank's credit policy. At all times, management must know the amounts authorized and outstanding, the average credit risk rating and the industry exposure for the portfolio as a whole. Sub-reports should provide such information as the total exposure and the average risk rating by industry. Good MIS means that management will have the flexibility to change existing policies or to implement new ones as appropriate. Such flexibility is vital, particularly in an emerging economy with a natural resource base such as Mongolia, where economic conditions can change very rapidly, thus calling for different policies to ensure continued stability.

The Role of Bank Directors

Directors have an important role to play in preventing a bank from pursuing bad credit policies. A bank director's responsibilities in Mongolia have changed considerably under the new economy. Senior management should therefore be required to present the proposed initial credit policy, together with any subsequent changes, to the bank's board of directors. If the directors find that the policy is acceptable, it should then be implemented. Senior management should make presentations and provide information to the directors on the loan portfolio on a regular basis. This may include post-director approval on loans made above a specified amount even though it may fall within the limits allowed by the Bank of Mongolia. The object of the exercise is to keep all directors, especially the outside directors, up to date on the quality and content of loan portfolio so as to ensure that it remains consistent with the policy that they have approved and that their guidance is sought during difficult times. If banks do get into trouble, it should not be a possible scenario for directors to claim that they were not being

kept informed. (See recommendations regarding director education and responsibilities under the Governance section of this report.)

The Role of the Bank of Mongolia

Once it has been established, a copy of the bank's credit policy should be provided to the Bank of Mongolia. As regulator, the Bank of Mongolia should require that the credit policy meets its minimum standards. In the event that the policy should **appear to be inadequate**, the Bank of Mongolia should discuss any shortcomings with the bank. In addition, at the time of the audit by the bank's examiners, the bank should provide the Bank of Mongolia with a written response to a series of questions covering current credit policy. The Bank of Mongolia's questionnaire should be completed by all banks to enable the Bank of Mongolia to compare and monitor the effectiveness of the credit policy in place in all Mongolian banks.

Current Credit Skills

Many of the banks' lenders have attended courses provided by the Banking Training Center and some have taken advantage of opportunities to attend courses and seminars provided by overseas institutions. We will discuss the current needs for credit instruction in Mongolian banks to enable lenders to effectively carry out credit policies under the Training section of this report.

INTERNAL CONTROL (AUDIT)

High priority must be given to a fully transparent internal control function in Mongolian banks, accountable to the shareholders through the chief executive and the board of directors. In addition, the Bank of Mongolia as the regulator, must be assured that the internal control function reflects an impartial account of the key operations and identifies operating weaknesses in addition to verifying that the bank is in full compliance with all regulations.

At the present time, the internal control function in Mongolian banks tends to resemble an audit of the entries which have already been processed. In the past, had there been an effective internal control process in place, early warning signals could have alerted the regulators and others of impending bank failures. While we are not suggesting that the banks would not have failed if the internal control function had been effective, it is quite likely that the situation would have been identified earlier and that action taken then could have prevented some losses.

As a separate process, there is a need to develop an independent internal credit review procedure on a regular basis to ensure that risk ratings are accurate and that management have a true picture of portfolio quality. This is a highly skilled exercise which is distinctly different for the control review over the rest of the operations.

We have used the term internal control rather than internal audit since the process must go well beyond merely verifying that the entries passed on a day-to-day basis are correct. The process must be proactive and anticipate problems in addition to checking historic activities. What is really needed is a control function which provides early warning signals. It should also identify existing control and operating weakness and be able to provide recommendations for improvement. It is not sufficient to merely check entries within an internal operating system which is not efficient and may even be flawed.

Personnel responsible for internal controls should always report to the chief executive officer and the board of directors. This is not a problem since the Bank of Mongolia insists on this structure. However, if the control function reveals insider trading activities, it places control staff in a difficult position since the perpetrators of such illegal activities are often the very people who they report to. Consequently, it must be made clear to internal control personnel that if no action is taken by the senior management and directors to investigate and report insider dealings revealed by them, then they have an obligation to report the matter to the bank's' internal auditors and/or the Bank of Mongolia.

In order to provide the necessary early warning signals of internal problems, the Bank of Mongolia must insist that every bank implements a program which meets their criteria. It is unlikely that banks can design an effective internal control system themselves since it requires specialized expertise based on extensive experience in the field. Consequently, we believe that all banks should seek the assistance of their external auditors to design a control program to meet the needs of the bank. In turn, the external auditor should consult with the Bank of Mongolia to ensure that the parameters of an effective program are established. The program should be approved by the Bank of Mongolia as regulator, prior to implementation. Furthermore, it will be necessary for the banks' control personnel to receive specialized training in order to meet the needs of their job requirements.

LEGAL

A sound commercial legal system is essential for a successful banking environment. The processes of taking, registering and liquidating collateral call for reliable, consistent and clear rules. There must also be predictability of outcome of litigation based on the law and courts and judges must be impartial.

A great deal has been accomplished in Mongolia over the past 10 years in designing a body of commercial law suitable for a modern functioning economy. Much of the new legislation required is either already in place or is scheduled to be implemented in the near future; this is not a problem. However, given the need for the country to assimilate such drastically new legal concepts in a relatively short period of time, it would be surprising if there were no problems at all. While there seems to be some incompatibility insofar as the new legislation is concerned, often due to political interference, the major shortcomings relate to the implementation and execution of the new legislation.

It will be necessary to re-educate all those who are involved with legal matters. Judges, prosecutors and lawyers for financial institutions and corporations will have to undergo extensive retraining if they are to understand and interpret the new laws. Law schools must incorporate the new legislation into their curriculum so that graduating students are versed in the new legal processes. This will be a very difficult task and will take a long time to accomplish. In the meantime, a backlog of cases is likely to swamp the legal system and very little practical improvement will be immediately evident. For example, there were only five bankruptcy proceedings initiated in Mongolia during the whole of 1999. In an effort to enable implementation of the new insolvency legislation, the World Bank's project known as the Banking, Enterprise, and Legal Technical Assistance Credit (BELTAC) is providing a number of 2-week seminars to legal professionals at various government ministries, as well as to judges, police, prosecutors and university law professors in an effort to bring these people up to date. We understand that the BELTAC project has been somewhat disappointing in that it may not fulfil its mandate and deliver the basic of knowledge of the new commercial legal system to the stakeholders. Nevertheless, since the project is due to expire in April of this year, we recommend a follow-up project with the emphasis on implementation of the new legislation.

Another area of concern for banks is the registration of collateral. Private property is a relatively new concept and registration has not been necessary until recently. An attempt is being made to establish a computerized registry system in the capital for immovable property, such as real estate, which should take in around 90% of the country's current requirements. Once this has been accomplished, it will greatly assist the banks in properly securing loans.

There could be a lengthy period of time which could last for several years, when banks do not have the proper commercial legal framework in which to operate from a practical point of view. The laws may be in place, but the delay in the execution of these laws means that banks have a problem in securing new loans as well as successfully working out the many bad loans they already have on their books. In this regard, special attention should be paid to the training of bailiffs and others engaged in the physical execution of judgements and court decisions. It may also be necessary to review the compensation of these people to ensure that they are committed.

Another factor which may affect civil court judgements and cast doubt on the impartiality of the legal system is that judges receive a "budget" salary and, thus, are not well compensated. Consequently, their expertise and integrity may not always be at the level which provides the necessary degree of confidence that decisions rendered are of the highest order.

Given all of these shortcomings to due process, the legal environment in which banks have to operate is very difficult. The professional legal staff employed by the banks is generally considered to be at the higher end of the market. Moreover, banks tend to also draw on the best available outside legal counsel in situations where their own legal departments are not equipped to handle some of the more complicated issues. However, in the short term, banks can be expected to continue to have great difficulty in

overcoming the legal impediments even though appropriate legislation is in place. Under the circumstances, the best approach is for the banks to ensure that their own staff, particularly those involved on the legal side and in lending, become as expert as possible on the current legislation in order to protect their interests as much as possible. As the legal environment stabilizes, the banks will thus have a comparative advantage in dealing with legal matters. This is another area where specialized training for bank personnel will be valuable.

ACCOUNTING

Banks have two interests in having good accounting standards in place. First, a bank must be able to trust the audited statements of its customers in order to make good credit decisions. Second, a bank's own accounting procedures must reflect the true position of the bank's financial standing. In both cases, the primary characteristic of financial accounting is that it generates information that can be used for management and planning.

While current bank accounting is not strong, it does appear to be reasonably accurate. In the near future a new accounting system will be installed in six of the banks, starting with TDB, which should upgrade the banks' accounting to internationally acceptable levels. The progress in this area is described in the Systems section.

International Accounting Standards (IAS) have legally been required for financial reporting in Mongolia since 1993. As with many laws, however, the implementation has been slow. In the past year Arthur Andersen has been working with the Mongolian Institute of Certified Public Accountants to administer an international-standard CPA exam, and eighteen people have successfully passed this. There is also a local entity, the Mongolian Professional Accounting Council, affiliated with the Ministry of Finance, which offers accounting review courses and a certification program, and reviews accounting software programs for IAS compliance. While Arthur Andersen has some issues with the quality of the work being done by this entity, it is significant that it is offering training in the aimag centers.

One major issue in the promulgation of international accounting standards in Mongolia has been a question over the quality of the translation into Mongolian. In a word, the translation is poor, with conflicting and simply incorrect terminology. While this is not a problem for the banking system to solve, it is an issue that requires immediate attention before IAS will or should be accepted.

The use of IAS may be one area where the banking system is giving, rather than getting, advice. One major way to upgrade financial statements is for the users to demand higher quality information. This means that if the banks will insist on getting appropriate statements from their clients, and the bank examiners in turn look for IAS standard statements on borrowers, at least the businesses that get loans will produce better quality financials.

Certainly IAS quality statements should be expected from businesses of a certain size, or for loans over a certain size. However, it is not realistic to think that very small businesses will produce statements other than for the tax authorities, and the banks need to deal with this practical situation. We would recommend that the Banking Training Center develop a course on using tax statements for financial information, and that the BTC, the Bank of Mongolia, or a banking consortium (or a combination of all three) develop an application/financial statement form that would be easy for businesses to complete, yet would provide ample information on income and cash flow for loan analysis purposes.²

HUMAN RESOURCES

In order for the banking industry to succeed, it must attract the best and brightest talent. For this to happen bankers must be adequately compensated, have job satisfaction, and have good career opportunities for advancement based on merit. In discussion with the banks and the universities we see that banking is considered an attractive career choice among graduates. Further, it appears that wages being paid are appropriate, albeit frequently paid in a form that will not be subject to the 40% tax rate.

In general, however, we are not seeing written job descriptions, career paths defined, or bank-wide personnel evaluation schemes. While job performance is being measured, it is being done only at a departmental level, and no institution-wide performance standards are in place. We would encourage more work on this by the individual banks.

In addition to developing personnel policies, it would be appropriate for the banks to develop financial incentive programs for staff, particularly loan officers and other public contact personnel, and for bank directors. Such programs must be designed so that they reward behavior that is beneficial to the bank, and are simple to administer. For instance, branch personnel might be rewarded for an increase in new deposits over time. Loan officers can be incentivized by payment for new loans over a period of time, following successful repayment of the loans. Bank directors should be paid for attendance at board meetings. In addition to encouraging job behavior that benefits the bank, such incentive programs have the advantage that they discourage self-dealing behavior. For instance, if a loan officer knows that he will be rewarded for good loans, he is less likely to take inappropriate payments for any loan that he grants. Financial incentives can also be used as a team-building device, if incentives are paid for overall bank performance, or for departmental or branch performance.

At the same time, the banks should not tolerate any illegal behavior, including any sort of self-dealing. The banks need to establish a code of conduct, which should be reviewed and approved by the Board of Directors, which must be strictly enforced. Any actions by employees or directors that constitute illegal acts should promptly be referred for criminal or civil prosecution.

² This sort of standardized statement has been developed for use in the American banking system by Robert Morris Associates, a professional association for bank lending and credit officers.

Another way that the banking industry may be able to professionalize itself and bring more prestige the field is through the creation of certification programs in certain positions, such as

- loan officer
- internal auditor
- bank accountant
- bank director

A certification might include minimum time on the job, a set of required courses, and an examination. This sort of program would be an appropriate activity for a banking association.

Even prior to the institution of a certification program, the Human Resources department has an obligation to ensure that employees receive proper training. In addition to encouraging attendance at BTC classes, we recommend that the banks continue to pursue international work and training opportunities for their employees, as this sort of on the job training can create great leaps in understanding. Further, encouraging employees to learn business English will permit them to keep up with international information sources on their own.

Another major issue for the banks and the Bank of Mongolia is the quality of the graduates of the universities, who will be come the next generation of employees. There are three universities or schools in Ulaan Baatar which offer undergraduate education in banking, finance, and business topics. These include:

School of Economics Studies at the National University of Mongolia – This university was founded in 1947, and in 1999 had 234 graduates in disciplines such as business administration, marketing, management, accounting, finance, insurance, banking, tax, statistics, and economics. The economics faculty has cooperated with TACIS, as well as various universities abroad (particularly the University of Manchester in the UK) in developing programs, and several of the professors have studied abroad.

Institute of Finance and Economics – This was originally established in 1924 as a vocational program, but in recent years has been upgraded to a university level program. There are undergraduate programs in accounting, business studies (mostly marketing and management), and banking and finance, with 80 graduates last year in banking and finance. Foreign assistance has mostly come from individuals such as Peace Corps volunteers and Volunteer Service Corps members, rather than from institutional sources.

Khan – Uul Institute – This is a private university that was established in 1993 by a former professor of the National University economics faculty. It conducts a five year program, with graduates receiving two bachelor degrees, in mathematics and economics. 22 students were graduated last year. A business course is covered, with emphasis on quantitative methods and computer simulation models. The Institute uses foreign books, magazines, and internet sources to keep up to date.

Graduates of all three of these universities do go to work for the banks and the Bank of Mongolia, and these are regarded as prestigious appointments. (While in prior years the banking sector was the first job choice, accounting is now preferred, because the banks are not hiring as many students fresh out of school, since there are more experienced bankers around from the failed banks.) The universities do have contacts with the banks and the Bank of Mongolia, and both National University and IFE professors are also trainers for the Banking Training Center. There are also examples of internships for university students in the banks, which certainly should be encouraged. In general the theoretical training that students receive is regarded as good, but both sides concede that more practical application of studies is needed. It seems that over time the preparation done by the universities will improve, and it will be important for university and bank officials to continue to communicate about educational needs and the relevance of undergraduate course material.

BANKERS ASSOCIATION

A bankers' association was founded in Mongolia in 1994 but ceased operations in 1998. The association had a staff of four including a secretary and driver besides an executive director and his assistant. All banks were members and the annual membership fee was set at 1% of total assets. Many of the banks did not pay what they perceived to be an unacceptably high fee so the association was disbanded due to lack of the necessary support from the banks. However, the time is now ripe to resurrect the banking association as it could play a key role in the development of the commercial banking system in Mongolia. Banking associations work well when there are only a few banks in the system, which is the case in Mongolia, since each institution can be represented and, therefore, have a voice in the association's affairs. A Banking Association will also counterbalance the overwhelming influence of Trade and Development Bank which accounts for around 40% of total banking assets.

The main purpose of a bankers' association in Mongolia would be to function as a clearing house for communication and channelling information flows between the banking system and external bodies. For example, the banks would be able to deal with the Bank of Mongolia and the government through the association, resulting in more efficient communication and enabling the banks to speak with one voice on matters affecting them. The association would enhance the development of banking in Mongolia by facilitating discussions between banks on topics of mutual interest. On issues affecting the banking industry as a whole, the combined efforts of the member banks would likely be more fruitful than each bank tackling the same problems individually.

At the outset, a number of committees should be established to bring together the officers of each bank responsible for a particular function. The executive committee, as the most senior committee, would consist of the CEOs of each of the member banks. Following the establishment of the executive committee, a credit policy committee consisting of the chief credit officers of each bank should next be set up to discuss credit-related topics which affect all banks. Other main committees which could be established include:

accounting, internal control (audit), systems, international, legal, treasury and human resources. The most senior officers in each bank responsible for the particular functions would represent their banks on the committees. Such committees should report to the Executive Committee although sub-committees could be formed for less important functions. One of the banks' representatives would be elected chairman of each committee and the executive director would also attend each committee meeting since it is that person who would be charged with the coordination of the association's business. It may not be necessary to establish all of the aforementioned committees immediately and additional committees and sub committees can be formed later as required.

Once the association has been in operation for some time and has gained the confidence of members and non-members alike, it could take over the role of training from the Bank of Mongolia. An education arm could be formed and member banks would be able to design training programs to meet the needs of members. A program could be established leading up to a professional designation, e.g. a Fellow of the Mongolian Bankers' Association diploma, which would be recognized as being on par with designations from other professional bodies such as law and accounting.

Another advantage for banks in having an association is to have a body which can promote the banking industry to the public in general, both businesses and individuals, thus contributing to a positive image. This can be done through advertising campaigns, publications and a numerous other ways such as seminars for the public. It is a way to provide information which will promote increased public awareness and thus participation in the country's banking system.

An effective association will take several years to develop. From an very small operation initially, the association could gradually build up over the years to become an important body handling many responsibilities other than those envisaged at the start.

In the beginning, the association could be as small as just an executive director with secretarial support and perhaps office space donated by one of the member banks or the Bank of Mongolia. One of the first tasks of the executive director would be to establish a budget for the initial year's operations. The budget would be approved by the executive committee and the membership fees established.

There will be some challenges in setting up an effective association which will work actively for all its members, but these hurdles can be overcome. One such challenge will be the funding of the association since one bank, Trade and Development, is so much larger than the others. Eventually, it will have to be decided whether each bank should contribute an equal amount or whether contributions should be weighted according to size. The answer to this question, however, should be postponed until the costs of operation have been established. In any event, it should not be such a large problem that it prevents an association from being formed. An approach to consider at the outset would be to seek foreign funding to launch and maintain the association for at least the first year or so. This would ensure that funding did not become the major hurdle for going ahead with such a body which clearly would have significant benefits for the Mongolian commercial banking system.

Another challenge will be to identify and appoint an executive director who has the capability to establish and develop a successful association. A high-powered individual to provide leadership is the key to the success of any industry association. The executive director will need to gain the respect of senior bankers at the member banks as well as key people at the Bank of Mongolia and in government and business circles. The person appointed to the position need not be a banker, but should be familiar with the key fundamentals of banking and, importantly, should have the right contacts in government and business circles in order to promote the interests of the member banks. Such a person should be equivalent in perceived seniority/status to at least the deputy chief executive level within a commercial bank. It is important that compensation be set at a level which will attract the best candidates for the job. A search committee should be established consisting of the CEOs of member banks. Candidates should be proposed by member banks and the successful candidate selected by the search committee.

Soon after the executive director has been appointed, a visit should be arranged to meet with senior officials of a banking association in a country where a bankers' association has been established for many years and has a successful track record. There is no substitute for observing the way a seasoned body operates in order to develop a new operation from scratch.³

Finally, a medium and long term plan, for the next five to ten years, should be submitted to the executive committee to ensure that all banks are in agreement and give full support to the direction the association should pursue. In conclusion, the formation of a Mongolian Banking Association could contribute significantly to raising the standard of banking throughout the country. The association would assist in creating a positive image of banking and bankers thus helping to make banking a prestigious and sought after career. Consumers, both business and personal, would also be beneficiaries.

SYSTEMS

Efficient computer and manual based systems are essential for the successful operation of a modern commercial bank. At present the banks are running their accounts and loans on various systems, which may or may not be fully compliant with International Accounting Standards. The general view seems to be that accounts and reports (such as those made monthly to the Bank of Mongolia) are fairly accurate, but are less useful for management information and planning. This means that the systems in use at present contribute to the prevailing disconnection between financial reporting and management planning.

³ One possibility is for the executive director to visit Canada where a successful association, the Canadian Bankers' Association which has operated for more than 100 years, could be a model for the Mongolian banking system's association. The structure of the banking industry in Canada is somewhat similar to that in Mongolia in that there are a small number of banks, most of which have a national as opposed to regional presence. The structure of the two banking systems is likely to converge even more as contraction occurs in the Mongolian banking sector brought about by mergers due to minimum capital requirements. Funding for such a visit to study the activities of well established and successful banking association should be outside of the new association's budget and an attempt should be made to see if costs could be covered by the foreign association. It would also be of value to recruit a former officer of the foreign association or a similar organization to assist with the start up if funding can be obtained.

The Asian Development Bank has recognized this problem, and has contracted with an Australian firm to modify and install a comprehensive financial accounting system in six of the banks. The first installation will be in TDB, followed by installations in Erel Bank, Ulaanbaatar City Bank, the Savings Bank, Mongol Post Bank, and the Agricultural Bank. (Golomt Bank has recently installed its own new accounting system.) The ambitious schedule is that the system will be installed in several banks by the end of the year, so that the banks can run both systems for about six months. Realistically there may be a delay, but the new system should be in wide use at some point in 2001.

This change in systems affords a tremendous opportunity for increasing the financial management skills of the Mongolian bankers. For the first time, the banks will have financial reporting systems that can be used in management planning. This means that asset and liability management classes can be taught on more than a theoretical basis, and course participants could be expected to go back and immediately apply lessons, using their own bank's financial information. There is a training element in the systems installation project, but it is important that this not be limited to bank information technology managers and accounting managers, in merely showing them how to run the system. There is a tremendous opportunity to capitalize on this change to educate the senior management and bank directors on integrating financial information into the management function.

In a sense it is beneficial that the new system is not being immediately installed in the banks, because the approximately one year lag allows for the planning time needed to design and promote training classes in a new style of financial management. We recommend that the Bank of Mongolia, working through the Banking Training Center, develop or modify bank financial management training programs that would be targeted to senior management and board members. Some of the funding needed for such course development may be available through the existing ADB contract (although we are not recommending reducing the training needed to properly educate the accounting and information technology staff on the running and use of the new system), but this would certainly be a priority use of other funding, given the tremendous opportunity to further professionalize the top management and directors of banks. Ultimately it would be appropriate to charge cost-recovery fees for participation in such training.

Another information system that is in place and is functioning is the Credit Information Bureau, which is maintained by the Bank of Mongolia. This is a manual database of information on borrowers, and recently has been restructured. Information is updated monthly, based on loan reports supplied by the banks and NBFIs in their monthly reports. At present information is only available on borrowers located in Ulaan Baatar, and data are not available on regional borrowers. The Bank of Mongolia properly acknowledges that security of data is an issue, thus only one person at each bank has access to the database. It should be noted that this sort of database is ordinarily maintained by a private company, on a for-profit basis. Given potential confidentiality issues, however, this may be an appropriate function for the Bank of Mongolia. However, we would encourage the BOM to operate the Credit Information Bureau on a cost-recovery basis,

and charge the banks for credit information reports. Eventually it may be possible to transfer this operation to a private company that is owned or directed by a consortium of the banks.

Finally, banks do find that using a computer-based spreadsheet and analysis program does enhance the loan analysis capacity. This is not the sort of system that needs to be identical across the entire banking system, and indeed different systems are appropriate, depending on different loan and customer characteristics, such as the size of the borrower, typical industry type, and loan length and purpose. It appears that both TDB and Golomt Bank will be installing new loan analysis software as a part of the pass-through term loan facility being granted from the World Bank. While this is not a human resources issue per se, we would urge the Bank of Mongolia, through its examination process, to encourage the banks to install and use such systems, including internal training to make the best use of this type of analysis tool.

CUSTOMER SERVICE and MARKETING

At present the Mongolian banking system is serving only a small percentage of the population, and the current slate of services needs to be upgraded. Certainly there are some imaginative steps being made in this area, and a few examples are in order:

- Golomt Bank is introducing bank cards, automatic teller machines, and 24 hour branches. It finds that suggestions for new products come from staff, directors, and customers (whom have often seen such bank services abroad). Its marketing department is tasked with determining the cost of offering the product, and assessing alternative deliveries of the same service. For instance, it decided to have some 24 hour branches rather than more automatic teller machines because the latter are more expensive. Both the internal audit department and the legal department are concentrating efforts on ensuring that product exposure and control are in place, and that personnel are appropriately trained, before these new services are offered to the public.
- Ulaan Baatar City Bank is essentially a boutique operation, and makes an effort to provide a high level of personalized customer service for its clients.
- Mongol Post Bank, in conjunction with the post office, has been carving out a rural market for itself. It is concentrating its training and product development efforts in this market, and is seeking lending licenses for its aimag branches so that it can expand its services. The JICA⁴ study does cite the Mongol Post Bank / Post Office partnership as an alternative to the Agricultural Bank for ensuring that banking services are available in the regions.
- The Savings Bank, which holds most household deposits, is seeking a lending license so that it can make loans other than those secured with deposits.

⁴ Daiwa Institute of Research Ltd. and Nomura Research Institute, Ltd., for Japan International Cooperation Agency (JICA), Ministry of Finance Mongolia, Draft Final Report, Rural Banking Services and Savings Mobilization, February, 2000.

While it is not surprising to find that banks are seeking to carve out a boutique or high end market, what is pleasing to see is that much of this attention is being directed to mass markets and rural markets. These initiatives underline the need of the government to get out of the banking business itself, and rather let free market competition meet customer need.

In surveying the banks we found that there is interest in customer service and marketing courses, and we would encourage development of such programs.

TREASURY

Good loan opportunities in Mongolia are not plentiful. Consequently, the percentage of loans to total assets is shrinking and many banks now have less than a third of their total assets in loans. This development poses the problem of how banks should effectively utilize non-loan assets. There needs to be other effective alternatives, otherwise banks may be tempted to utilize their excess liquidity to place substandard loans on their books in a futile effort to increase revenues. Moreover, they may also be tempted to invest in “bricks and mortar” or to make other non-liquid investments. Such investment developments would be detrimental to the overall health of the banking system and must not be allowed to occur. Viable investment alternatives need to be developed in Mongolia.

At the present time, opportunities for domestic money and capital market investments are very limited and the major outlet for liquidity is to invest in Bank of Mongolia bills which are relatively low yielding given the current high interest rate environment in Mongolia. Moreover, the interest rates on these bills have been dropping rapidly in recent times. A second avenue for liquid investments is to buy Government of Mongolia bonds which yield slightly more than Bank of Mongolia bills. A third avenue which has very limited depth at the moment is an emerging promissory note market consisting of paper issued largely by state-owned enterprises. Most liquidity is channelled into foreign currency deposits with foreign correspondent banks, but the interest paid on such deposits is also very low. While there are regulatory limits to foreign currency exposure (10% of a bank's capital) this does not prevent this avenue as being the most active form of short term investment since a significant portion of banks' deposit liabilities are also in the form of foreign currency. Banks do not purchase foreign treasury bills and other money market instruments but place time deposits and receive a return slightly below market rates.

In the future, new investment opportunities will become available to employ liquidity as money and capital markets in Mongolia develop. When that occurs, banks must have the skills to safely invest their non-loan assets in order to maintain liquidity, thus ensuring that they can meet all reasonable obligations on a day to day basis. However, the employment of liquidity should also be a profitable venture and it takes considerable skill to strike a balance between safety and return on such liquid investments. The treasury function within a Mongolian bank is relatively straight forward at the present time given the limited opportunities available. However, as the money and capital markets expand,

personnel will need to have specialized training which is not currently available in the country. Consequently, in the initial phase, such training can largely be handled locally through Mongolbank courses and on the job training. In the future, the facilities of foreign correspondent banks and international organizations will be required in order to handle the training needs for the more sophisticated investment transactions.

INTERNATIONAL

Mongolian banks need to be integrated into the international banking system in order to provide the necessary support to their customers activities, particularly as they relate to foreign goods and services. Since Mongolian banks are unlikely to open foreign operations themselves in the foreseeable future, such activities will necessarily be in conjunction with foreign banking correspondents. In our discussions with Mongolian banks, foreign correspondents are chosen not only on the basis of the need for “nostro” accounts, but also for the other services they provide, including training. Mongolian banks have often been able to convince their foreign correspondents to underwrite the costs of employee travel and accommodation while undergoing bank training in the host country. This is a good use of a correspondent relationship which Mongolian banks have been able to exploit.

Limited international services are currently being offered and, apart from foreign exchange, the most prevalent is the handling of incoming and outgoing foreign payments. This seems to be well established through the SWIFT system in which some Mongolian banks have membership. While a few documentary credits and collections are processed, this is an area which will need more attention in the future as Mongolian companies increase trade with the rest of the world. The skill and expertise required to handle documentary credits is built up over a long period of time in the performance of such activities. While training courses can be helpful, this is probably one field where the most effective way to acquire such expertise is for Mongolian banks to identify personnel who are destined to become future heads of the international departments, and seek opportunities for training programs in correspondent bank documentary credit departments.

With regard to foreign exchange, there is little need for banks to become experts in the field as opportunities are basically limited to buying and selling foreign currency from their customers. Also, Mongolian banks are not permitted to take meaningful positions in foreign currencies. There is no forward market for the Mongolian togrog and one is unlikely to emerge in the foreseeable future. Consequently, the major opportunities in the foreign exchange field consist of improving existing operational procedures to ensure customers receive good, low cost service. However, at some point in the future, foreign exchange trading expertise will be necessary and at that time, the Mongolian banks will have to ensure that their staff gain the necessary skills to participate in the market. Once again, hands-on experience will be more effective and it is likely that the expertise will be gained from personnel being trained “on the job” by foreign correspondents.

BANKING SERVICES IN RURAL AREAS

Mongolia is a huge country with a small population, and an extremely low population density. There are twenty-one provinces or aimags, excluding Ulaan Baatar, the capital city. The aimags each have some fifteen to twenty soums. The distances between the aimags and Ulaan Baatar may be over a thousand kilometers, and the distance between a soum and the aimag center may be over a hundred kilometers, over poor or non-existent roads. As has been extensively documented in a JICA study,⁵ banking services, particularly for cash payments, are needed in these rural areas. Soum residents, however, are reluctant to put their money in banks because they do not trust them, principally because they are illiquid.

The problem of delivering banking services to the rural areas is certainly acknowledged by the Bank of Mongolia, and this is the principal reason why the Agricultural Bank, the only entity with a significant rural network, has been in an extensive receivership /workout so that it can continue to provide payment and some other banking services. There are some alternative banking services in some of the aimags, but none of these is as extensive as the Agricultural Bank network. Mongol Post Bank, in partnership with the post office, is offering some payment services such as money orders, at the soum level. Currently it only makes loans in Ulaan Baatar, but will expand lending to its aimag center branches shortly. TDB and the Savings Bank each also have some rural branches.

At this point there is very little lending going on in the soums. The Agricultural Bank plans to restart lending small sums, and there have been some initiatives in lending by non-bank financial institutions, but these are mostly confined to aimag centers thus far. As noted elsewhere in this report, there is very little formal lending going on anywhere in the country, and several factors unrelated to the rural circumstances will have to be addressed to correct this overall situation.

From a human resources point of view, the major concern about rural banking services is whether there are people in the rural areas who have the training and skills to carry out banking services. At present the quick answer is that the rural staff of the Agricultural Bank, whether employed by the Agricultural Bank or another entity, do have the money-handling skills needed for payment services, but only have minimal lending skills. A substantial concern is the need to keep these skills fresh and updated, and to make sure that current information, such as on legal and regulatory changes, is adequately disseminated outside of Ulaan Baatar.

Mongol Post Bank has been taking some steps to increase the training available to its rural staff, and is seeking more courses on topics such as foreign exchange, international settlements, and bank guarantees. The Agricultural Bank has not been healthy enough to focus on training, but plans to re-start its in-house training programs in the future. Once a course of action is committed to, attention should be devoted to distance learning solutions, eventually incorporating internet delivery. Again, this training and information

⁵ Ibid

dissemination should be broadly available, to encourage market solutions to the problem of delivering banking services in the regions. At present it is understandable that the Bank of Mongolia needs to ensure that banking services are available at the soum level, but this solution should not exclude other institutions from seeking a rural market. The wide availability of training and current information through distance learning sources will enhance the attraction of the rural markets, since banks and NBFIs will have fewer staffing issues.

In discussing distance learning for the rural banking system it is important to understand that there is limited telephone service in the regions. Currently there are tremendous limitations on the electronic delivery of courses in the rural areas, as only some of the aimags have communications lines that are good enough to permit internet browsing, and some have telephone lines that will not permit e-mail attachments of more than 50 kilobytes, a relatively small amount of data. Some of the soums do not have reliable telephone lines, electronic delivery of courses is not a widespread realistic possibility for the near future. The Ministry of Infrastructure is paying attention to this problem, and presently is working with German and South Korean assistance to install fiber optic cable lines from Ulaan Baatar to one of the aimags. It will be important for the BTC to keep track of the developments in this area, so that it can anticipate when it will be helpful to the banking system to make a serious commitment to training via internet.

In the meanwhile, there could be substantial delivery of training in the aimags through CD-rom. There are computers available in the aimags, so once CD-roms were physically delivered to an aimag, participants could work through courses there. It is easy to envision the branches of the Bank of Mongolia setting up small training offices with computer capability, where participants could work through course material and finally e-mail test answers to a trainer in Ulaan Baatar for comment.

NON-BANK FINANCIAL INSTITUTIONS

Non-bank financial institutions, or NBFIs, include alternative lenders to the commercial banks such as finance companies, leasing companies, cooperatives, and microfinance programs. At present these only have a very minor presence in Mongolia, but do have potential, particularly for credit delivery at a consumer level or in the rural areas. One program that was started as a donor initiative, the finance company X.A.C., books some 600 loans per month, and indicates that it is now operating profitably, on a cost recovery basis. This operation may be a model both for other programs and for the banks themselves, as a demonstration that high volume, small loan programs can be profitable. Additional donor programs of this type are being started, and interestingly, they are being incorporated as for-profit finance companies rather than as NGO programs, which suggests that they intend to be around a lot longer than just the life of their program funding.

These finance companies are licensed, and examined, by the Bank of Mongolia, which we applaud, because it means that these new entrants to the financial market will be credible to businesses and consumers. To date the Bank of Mongolia has been supportive

of these institutions, and we urge that this be continued and expanded. In keeping with the idea that human resources planning should primarily be targeted to the as yet unknown “survivors” in the financial system, it is important that all training and other development opportunities also be available to these NBFIs, which could form a critical role in delivering banking services.

TRAINING

Training at all levels is a key element to a successful banking career, and successful and knowledgeable bankers will contribute to a viable financial services industry. This is a broad category that touches on several other topics in this report.

The Mongolian banking system has received a substantial amount of training in the past, particularly in credit evaluation. Overall, the view is that this training has not been effective, as substantial amounts of training seem to have had little effect on the number of problem loans, and other management problems that have beset the banks. The key to successful training, however, is timing, so that bankers are trained and can immediately implement the knowledge that they have learned. It seems that training has been ahead of other bank reform and changes: for instance, a course on asset and liability management, based on western circumstances, is virtually inapplicable in a banking system with no investment instruments. We do believe in the value of training, but strongly feel that it should realistically reflect the current situation in the country. Since it is impossible to recast all existing courses immediately, we recommend that courses be revised and updated as the subject is in demand, and there are current legal changes or market shifts that create an interest in the subject.

There should always be an on-going need for training to acclimate new employees, to introduce new concepts, and to brush up on techniques, so a strong training capacity should always be available. The major initiative in this area has been the development of the Banking Training Center (BTC) under the auspices of the Bank of Mongolia.

Banking Training Center

The BTC was originally established in 1997, and established its core curriculum through an Asian Development Bank project in 1998. Through this program there was an extensive Training of Trainers program, enlisting bankers and local university professors to deliver banking courses that range from one to two days to two weeks of half-day classes. Course materials for ten courses were developed or adapted through a cooperative process among foreign and Mongolian trainers. Participant materials, leader’s guides, and overhead transparencies were developed for each course.

Titles are as follows:

Core Courses

- Bank Mathematics
- Accounting for Bankers

- Introduction to Securities Markets
- Financing the Growing Business
- Principles of Trade Finance

Advanced Courses

- Bank Branch Management
- Auditing and Control for Bank Managers
- Credit Risk Management
- Asset and Liability Management: BankExec International
- Foreign Exchange Risk Management

The development/foreign assistance phase of this project was completed in April, 1998. Thereafter the BTC continued to offer classes, although experienced a disruption of services because of personnel changes. Mr. G. Tserenpurev has been heading the center since May of 1999, and the BTC has been offering two or three courses per month since. While the banks and the BOM comment favorably on the courses and the Center, it seems that there is a declining interest in the courses presently available, because most of the lenders and examiners have taken them. Since these are core courses that would certainly be useful on an ongoing basis to bankers, particularly to new hires, it seems that some refreshing of the course materials, including developing new cases, is advisable.

An additional seven to eight courses are being made available through the Swedish International Development Agency, including topics such as bank management, documentary credits, and international and domestic settlements. The ADB is also providing a new course of study on loan management. These new offerings are being coordinated through the BTC, which is also working with individual banks on in-house training.

The BTC recently surveyed its members for additional training requests, and is considering offering up to sixteen new courses. Subjects of particular interest for which the Center has no material include Ethics, Banking Law, Marketing, and Customer Service Management. There is also a strong interest in Business English. As the Center is developing new courses and updating others, it will need to consult with experts in the field, to ensure that material is up to date and relevant. (Note that the development of a Business English course is likely to be particularly lucrative, as it would be an on-going program, and is in high demand.)

The Center is operated on a cost-recovery basis. Commercial banks pay a membership fee of MNT 1.6 million, plus a per-participant charge of MNT 2,000 for each course. The Bank of Mongolia also finances 20% of BTC costs. Trainers are paid on a per course basis, and are not staff members. The Center has three staff, and operates from the Institute of Finance and Economics, where it has a renovated, equipped classroom that will accommodate 25 – 30 people.

At present the BTC is operated under the auspices of the Bank of Mongolia. In several countries bank training is sponsored by the banking industry itself, and plays a significant role in professional development and standards in the industry. Eventually it may be appropriate to transfer control of the Center to a bankers' association.

In the meanwhile, however, it is important that the Center be as institutionalized as possible, and not merely have a life tied to a particular donor project length. The BTC is the major provider of professional development training in the country, and should not be allowed to wither because its course offerings need updating. For the time being it is recommended that all training sponsored through donors be offered through the BTC, both to strengthen the Center and to assure that courses are available to all possible takers. The Bank of Mongolia should also be prepared to provide financial resources as necessary to ensure the permanence of this training institution. At the same time, cost recovery needs to be the watchword: training has value, and the banks should be willing to pay for this, since they will profit from more competent employees.

Foreign Study Tours and Training

Many of the bankers and the Bank of Mongolia staff have had the opportunity to participate in study tours and training. Broadly available foreign study has included:

- Another part of the ADB technical assistance credit that provided the Training of Trainers and course development described above was a six week study tour for twenty-five bankers and Bank of Mongolia staff to Albuquerque, New Mexico in the United States, and to Germany in July-August 1998. This trip was a combination of course learning, much later adapted for use at the BTC, and visits to local banks. Many of the participants in this tour later contributed to the bank training in Mongolia through work on course development and as trainers for the BTC.
- Bank examiners and other Bank of Mongolia staff participate in programs and seminars sponsored by the International Monetary Fund and the Bank for International Settlements, at locations such as the Joint Vienna Institute and the Singapore Training Institute, as well as programs with correspondent central banks such as the Bundesbank and the Bank of England.
- The new course of study on loan management that is being provided by the ADB will include a training tour to Japan for three people.

Certainly foreign study is an important element in training, as it can very quickly expose participants to new ways of thinking, and handling bank work. The limitation of this approach is that it is very expensive, and directly benefits a relatively small group. While we would not abandon this approach (particularly if a sponsoring organization is covering the costs), we do favor spending limited funds on training in-country that can benefit a broader group of recipients.

Outreach Programs and Distance Learning

Mongolia is a very sparsely populated country, with a highly dispersed, rural population. There is general acknowledgement that banking services are needed in the aimags and the soums (see additional discussion of this issue under Rural Banking) but training bankers in the rural areas is not a small problem. There are several approaches that are being pursued, or which are worthy of additional attention.

Bring bankers into Ulaan Baatar for training (either in-house or at the Banking Training Center) – This is being done by the Agricultural Bank to some extent, and certainly has the advantage that program participants have the opportunity to interact with each other, which is a significant part of learning. The disadvantages are that travel is long and difficult, and the branch loses the services of its employee for a significant amount of time. We do not wish to rule out this delivery mechanism, because it may be appropriate for an extended course of study, and the atmosphere of being in the capital, with like-minded colleagues, can be very stimulating. However, alternative and supplemental training methods also need to be considered.

Present courses and seminars in the aimag centers – Some of this type of work is being done, or is being pursued at present. The Mongol Post Bank is arranging for the BTC to offer training in the regions on loan portfolio/credit management, and asset/liability management, which would also be available to employees of the Agricultural Bank and the Savings Bank. The Mongolian Professional Accounting Council offers a one month certification exam review course in the aimag centers, taught by traveling instructors. While this approach does not bring the courses to the soum residents, it does offer time and cost savings over bringing participants to Ulaan Baatar. There appear to be two circumstances when this approach would be particularly effective:

- Summer courses which could be taught by university professor/BTC trainers who would otherwise be on summer breaks. This would not require any additional modification or development of training materials, other than work that would be done for the courses as presented in Ulaan Baatar. The additional travel and per diem costs could either be absorbed in higher course fees or through underwriting by a donor.
- Seminars to cover a particular topic. This is a very desirable format for presenting new or updated information, such as changes in the law or in taxation. A seminar trainer/presenter would be hired to travel around the circuit whenever there is a relevant legal or regulatory change, and in this way the Bank of Mongolia could be assured that everyone, everywhere, is getting the same message. Such seminars, which typically would only last for a few hours each, could be attended by all of the stakeholders. For instance, a seminar on changes in the collateral law could be presented to bankers, BOM local employees, accountants, local judges and prosecutors, as well as local government administrators. In this way BOM could be assured that the same, consistent, message has gone out to all concerned parties.

Distance learning by correspondence, CD-rom, or internet – This type of delivery does not seem to be used in Mongolia at present, but certainly is appropriate for a rural population. As noted in the Rural Banking section, there are tremendous limitations on actual electronic delivery of courses in the regions at present, but course presentation through CD-rom is certainly feasible at the aimag centers (i.e., wherever there are computers) and hard copy correspondence courses could be used at the soum level. Course designers and information technicians would have to work jointly to adapt existing banking courses for CD-rom presentations, and trainers would have to be developed to conduct classes, or give feedback, to course participants at a distance. For the time being the existing BTC courses could be appropriately adapted. We recommend that as new courses are developed or modified, that it be a work requirement for the course to be prepared for delivery both for a classroom and for the internet. While the latter form currently could only be used in Ulaan Baatar and a few aimags, material that is prepared for the internet is equally usable in CD-rom form, and dissemination of class material could immediately begin this way. For some of the new coursework that is being requested by the banks, the use of gaming software may be the best way to present lots of practice material.

Another type of distance learning that we encourage is use of correspondence courses and internet learning. This is much less expensive than going abroad for a course of study, and means that important personnel are still on the job.

Seminars

Seminars are typically held to disseminate information on limited topics, often subjects that are new, such as changes in the law. The supervision department of the Bank of Mongolia holds its own seminars for its examiners on Friday afternoons for three hours, generally about every three out of four weeks. These are used to discuss laws, regulations, and guidelines, and are generally conducted by the person responsible for the topic, e.g., the person who drafted a law. The seminars are held at the BTC training room.

We find that seminars can be an excellent way to keep personnel up to date with current issues, but can also be a good communications tool. Conducting seminars need not be expensive, as speakers are generally volunteers. Possible seminar series might include the following:

Expand the Bank of Mongolia supervision department seminars – Instead of conducting these only as in-house presentations, do a second presentation for bankers. This would allow the Bank of Mongolia to educate and reinforce on issues that it finds weak in the banks. It would also increase the credibility of the Bank of Mongolia's authority.

Bankers conduct seminars for themselves – This is comparable to creating an in-house information source for the banks, similar to the program that the Bank of Mongolia has created for itself. This is an excellent activity for a banking association, and increases the professionalism in the industry.

Seminars for all stakeholders – Particularly with legal changes, there is a need for information to be disseminated outside of the banking system, and it would be helpful for more than just the bankers to hear explanations and discussions of changes. Such seminars could be sponsored by either a banking association or the Bank of Mongolia, and would enhance the leadership status of either.

Joint Work With Universities

The universities and the banking system necessarily have the same goals, and have skills and resources that they may be able to develop together. For instance, the National University, with TACIS assistance, is looking at outreach programs, and executive education, as possible income-generation sources. The Bank of Mongolia, or the banking industry, may wish to pursue a joint development program with the National University or other school to develop distance learning, or an executive banking degree program.

Resident Advisors

Several of the banks have, or have had, resident advisors whose primary role was to establish systems and effectively do on the job training. Golomt Bank, for instance, had an advisor for six months from Citibank UK at the time of its startup, and has an advisor newly arrived from Japan sponsored by JICA. Both Golomt and TDB will be working with a World Bank advisor on the approval of the first term loans approved under the new World Bank term loan facility. The Mongol Post Bank reports that it is getting a two year advisor through the Netherlands Management Cooperation Programme, a business volunteer agency. GTZ had made a long term commitment to the Agricultural Bank for technical and financial support for strengthening rural finance.

We encourage the placement of advisors in the banks, as the opportunity for this sort of one on one contact has been an excellent way for bankers to develop their skills. We would encourage, however, that to the extent that the Bank of Mongolia has an opportunity to direct this type of assistance, that they direct advisors to banks other than TDB or Golomt. This would be in keeping with the idea that the as-yet unidentified three or four “survivors” of the banking system need more assistance than those two.